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JAMES H. McKENNEY,
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Filed April 28, 1900.

United States Circuit Court of Appeals.

SIXTH CIRCUIT.

THE GUARANTEE COMPANY OF NORTH AMERICA,

vs.

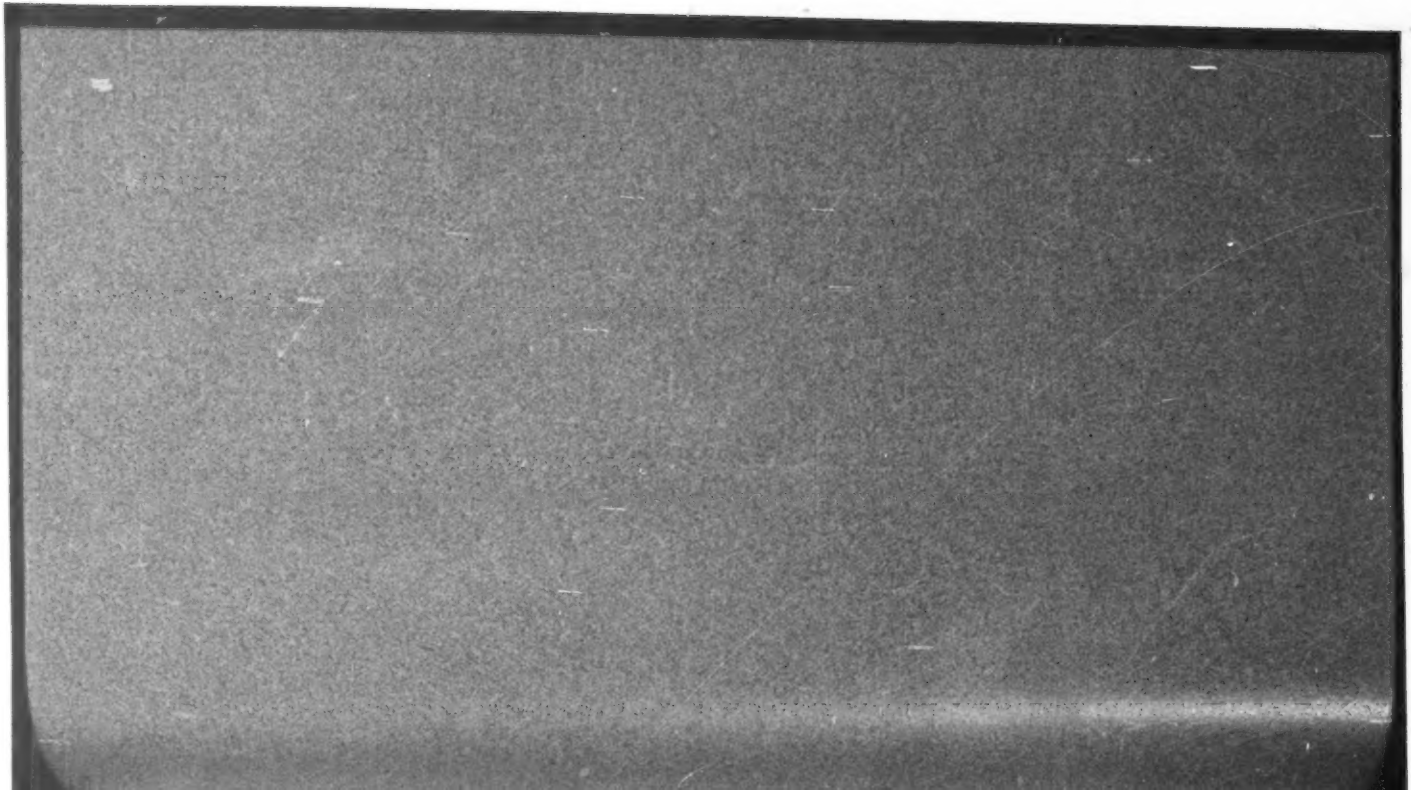
MECHANICS' SAVING BANK & TRUST COMPANY, FOR USE OF JAS. J. PRYOR, ASSIGNEE, ETC.

APPEAL IN ERROR.

BRIEF OF WILLIAM L. GRANBERY,
SOLICITOR FOR APPELLANT.

1900.

GRANDON PRINTING CO.



United States Circuit Court of Appeals.

SIXTH CIRCUIT.

GUARANTEE COMPANY OF NORTH AMERICA,
PLAINTIFF IN ERROR.

VS.

MECHANICS' SAVINGS BANK & TRUST CO., FOR USE, ETC.
DEFENDANT IN ERROR.

STATEMENT.

May it Please Your Honors:

This appeal involves the liability of a Surety Company under two bonds of suretyship issued to a bank to protect it against pecuniary loss resulting from the dishonesty of its teller and cashier.

The litigation originated in a State Court by bill in equity by the Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee, seeking to have an account stated between it and its former teller and cashier, John Schardt, to adjust certain equities between these parties, and to recover upon two bonds of suretyship issued by the Guarantee Company of North America to the Bank, upon Schardt, first as teller, and later as cashier of the Bank.

The case was seasonably removed to the United States Circuit Court at Nashville, Tennessee; and upon a hearing, a decree was rendered against the Company under each bond.[1] Upon appeal to this Court, the decree of the Circuit Court was affirmed.[2] The case was then taken by certiorari to the Supreme Court, where the

[1] 68 Fed. Rep., 459.
[2] 47 U. S. App., 91.

decree of this Court was reversed, because the decree of the Circuit Court was not a final one.[1]

After the cause was remanded to the Circuit Court, a final decree was rendered against the Company, and the case is again before this Court upon appeal.

The material controversy is that involving the liability of the Guarantee Company to the Bank under its two bonds of suretyship.

The Mechanics' Savings Bank and Trust Company, hereinafter called the "Bank," was a banking institution located at Nashville, Tennessee, with a capital stock of $50,000.[2] John Schardt was its teller from 1888 to January 1, 1893, when he was elected cashier, and remained such until his death, on April 17th, following. As teller and cashier he embezzled more than $100,000 of the funds of the Bank, beginning in 1890, and continuing until about the time of his death. About the time that Schardt died, the Bank, ascertaining its insolvency, closed its doors and made a general assignment for the benefit of its creditors.[3]

The Guarantee Company of North America, hereinafter called the "Company," is a corporation organized under the laws of the Dominion of Canada, for the purpose of guaranteeing pecuniary losses occasioned by the fraudulent acts of persons in positions of trust, and has been so engaged in Canada and the United States since 1872. In 1888 it issued to the Bank a bond, for a period of one year, on Schardt as teller, for $10,000, which was subsequently renewed each year until January, 1893, when it issued a bond on Schardt as cashier for $20,000. Generally speaking, each bond insured the Bank, under certain limitations and conditions, against pecuniary loss by reason of the fraudulent acts of Schardt in the respective offices held by him.

This defalcation of more than $100,000 was entirely lost in speculation,[4] and at the death of Schardt he had practically no property, but about $80,000 of life insurance, all of which he

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[1] 173 U. S., 587.
[2] Dep. Eatherly, q. 11, Trans., p. 51.
[3] Bill, Trans., pp. 1–5.
[4] Dep. Eatherly, q. 29. Trans., 53.

assigned to the Bank just prior to his death, to secure his defalcation.

From these collaterals the Bank has realized the sum of $46,838.46,[1] and for the remainder the Company was held liable to the extent of the amount of each bond.[2]

PROVISIONS IN EACH BOND.

In re Teller's Bond.

This bond states:

> "The following provisions are also to be observed, and binding, as part of this bond:
>
> [1] "That the employer shall at once notify the Company, on his becoming aware of the said employe (Schardt) being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits."
>
> [2] "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default."
>
> [3] "That there shall be an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months from the date of this bond.[3]

The original issue of this bond expired in January, 1889, and thereafter in January of each succeeding year. Before the bond was renewed each year the Company furnished the Bank with a blank form to be filled out, which provided as follows:

> "It is necessary, before the bond can be renewed, that you obtain the certificate hereon of your president or cashier, and on its return, with remittance of the premium, the renewal can be immediately effected."

The Bank executed and delivered the required certificate at the end of each year, and paid the premium of $100, which

[1] Trans., p. 119.
[2] Trans., p. 119.
[3] Trans., p. 13.

effected a renewal for the succeeding year. The certificate was filled in and signed by the cashier of the Bank, and among other things it stated that the accounts of said teller, Schardt, "had been examined and *verified* by the finance committee of the Bank"; and the bond was not renewed any year until this certificate had been made out and delivered to the Company.[1] The last renewal of this bond was in January, 1892.

In re Cashier's Bond.

In January, 1893, when the teller, Schardt, was elected cashier of the Bank, an application was made to the Company for a bond of $20,000, and before agreeing to issue it the Company required of the Bank answers to certain questions, which were addressed to Lewis T. Baxter, president, and distinguished as "Employer's Guarantee Proposal." In asking the questions it was stated: "In order that the directors of the Company may be fully informed in deciding upon the proposal, it is desired that the answers be as full and definite as possible, for mutual protection." Among other questions, all of which were answered by the president of the Bank on its behalf, were the following:

> "*Q.* 2. If a *new* employe, by whom was the applicant introduced, or how did he become known to you? If hitherto in continuous service, for how long, in what capacities, and has he uniformly performed his *duties* faithfully and satisfactorily?
>
> *A.* Applicant began service in this bank six years ago as collector clerk, and has since been advanced to Bank's teller, and now cashier.
>
> *Q.* 3. Has he ever been in arrears or default in the Bank's service, or, as far as you have heard, in any previous employment?
>
> *A.* No.
>
> *Q.* 4. Have you known or heard anything unfavorable as to his (Schardt's) habits or associations, past or present? No. Or of any matters

[1] Stipulation, Trans., p. 106.

concerning him, about which you deem it advisable for the Company to make inquiry? No.

Q. 9. Amount of bond hereby required, from what date to commence, and by whom premium will be paid?

A. Twenty thousand dollars, to date from January 1, 1893, premium payable by Bank.

Q. 10. What further security, if any, will be held or required from applicant?

A. None.

Q. 13. When were applicant's books and *accounts* (including cash, securities, and vouchers, if any), last examined, and by whom?

A. December 31, 1892, by finance committee of Bank (were they correct?) and found correct.

The above answers and representations are true to the best of my knowledge and belief."[1]

The cashier's bond was thereupon executed and delivered to the Bank, and among other things provided:

"Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the statement and declaration contained in a certain document, distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' on behalf of the said employer, and lodged with the said Company at its office in Montreal, . . . do hereby . . . covenant with the said employer to reimburse unto the said employer, etc."

"This bond is granted upon the following express conditions:

"1. Any misstatement of a material fact in the declaration within named, or in any claim made un-

[1] Stipulation, Trans., p. 109.

der this bond, will render this bond void from the beginning.

3. That any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, actions, or methods of supervision of the said employe, delivered to the Company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance."[1]

SPECULATION.

Schardt was a heavy speculator. Within less than two years his losses amounted to over $100,000. So imbued was he with the fever of speculation that he became part owner of a "bucket shop," or brokerage concern. In the summer of 1892, during the time the last renewal of the teller's bond was in force, and before the issuance of the cashier's bond, Sykes, the then cashier of the Bank, was informed of the conduct of the teller in this regard, and at once notified Baxter, the president of the Bank. Schardt was questioned on the next day, and admitted that at one time he had been interested in such concern, but had sold out his interest. He also admitted that he had been speculating to some extent, but had ceased to do so. Substantially the same things were stated by Schardt to Eatherly, a director and member of the finance committee of the Bank. Some time thereafter, and prior to January 1, 1893, when the cashier's bond was issued, Sykes, cashier, received an anonymous letter again informing him that Schardt was speculating. This was also laid before the president of the Bank. Eatherly also received an anonymous letter giving him similar information, which he showed to the president.

The entire testimony upon this question of speculation is here set out in detail:

[1] Trans., p. 10.

Testimony of Charles Sykes.[1]

Q. 5. Were you cashier of the Bank during the whole of the year 1892?

A. Yes, sir.

Q. 6. Did you, at any time during that year, receive information that John Schardt was speculating? If so, state when, how, and all the circumstances.

A. Yes, sir; I did receive such information. Some time in the summer or fall of 1892 a gentleman by the name of Kyle came here from New York, representing Myers & Co., of New York. Kyle wanted me to become interested in the brokerage business and represent Myers & Co. at this point. I told him that I did not like the idea, because it would be purely a speculative business, and he then said that made no difference, that John Schardt, our teller, was a partner in a similar concern.

Q. 7. Did you impart this knowledge to any one? If so, whom?

A. Yes, sir; I at once told Mr. L. T. Baxter, the pesident of the Bank, of the conversation.

Q. 8. Did you say anything to Schardt about the matter?

A. Yes, sir; on the next day, I think, I told Mr. Schardt of what Mr. Kyle had said.

Q. 9. What did Schardt say to you in reply?

A. He admitted that he had at one time been interested in such a concern, but had sold his interest; and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more.

[1] Trans., p. 77.

Q. 10. Did you impart this information received from Schardt to anyone connected with the Bank? If so, whom?

A. Yes, sir; I immediately told Mr. Baxter, the president of the Bank, what Schardt had said.

Q. 11. Did you receive any other information at any other time, with reference to Schardt speculating?

A. Yes, sir; some time thereafter I received an anonymous letter, telling me that Schardt had been speculating.

Q. 12. What did you do with it, and what became of it?

A. I showed it to Mr. L. T. Baxter, the president, and he said not to pay any attention to an anonymous letter; and I spoke to Schardt about it, and he said he thought he knew the author, and asked me to let him have the letter and he would bring the party before me and make him acknowledge it was false.

Q. 13. Did you give him the letter, and did he bring the party before you?

A. I gave him the letter, and asked him about it more than once, and he always replied that he was working on it.

Q. 14. Did you tell Mr. Baxter of this conversation?

A. I think I did.

Testimony of J. M. Eatherly.[1]

DIRECT EXAMINATION.

Q. 2. State what have been your relations with the Mechanics' Savings Bank and Trust Company for several years past.

[1] Trans., p. 50.

A. I was a director in the Bank from its organization until its assignment.

Q. 3. Did you fill any other position?

A. For a considerable length of time I was on the finance committee, and for about twenty days I was president of the Bank.

Q. 4. Please state what twenty days you were president.

A. I was elected on the 28th of March, 1893, and the Bank assigned on the 17th of April.

Q. 8. During what time were you on the finance committee?

A. I was, for several years, and prior to my election as president.

CROSS-EXAMINATION.[1]

Q. 98. Did you ever hear of Schardt's speculation before January, 1893?

A. I think I did.

Q. 99. Did you see the anonymous letter written with respect to his speculating?

A. I saw a letter directed to Judge John Woodard. Judge Woodard brought that letter to the Bank and showed it to me, and I asked permission to call Mr. Schardt up and show it to him, and he said that he was perfectly willing that I should do so. I at once called Mr. Schardt to where we were, and told him there was a communication I wanted him to read. He did so, and his remarks were: "It's a lie, and I can prove it!" In this letter it was stated that Mr. Schardt was a partner in a bucket shop. I told Mr. Schardt that it devolved on him to prove it false. I at once reported the contents of this letter to the president of the Bank, Mr. Baxter. Mr. Schardt asked that I and Judge Woodard remain

[1] Trans., p. 61.

there for a few minutes. He went out and got Frank Searight and Dr. Barry. Judge Woodard, Mr. Baxter, and myself went into the rear of the Bank building. Mr. Schardt and the other gentlemen came back, and Mr. Schardt says: "Here are the men who can tell you whether that is so or not." I asked them if they knew why we had sent for them, and they said Mr. Schardt had told them. Mr. Searight said that, some time before, Mr. Schardt, Dr. Barry, and himself had agreed to open a brokerage association. They objected very much to the term "bucket shop." Each one was to put in a small amount, $200, I think. Mr. Schardt in a short time became dissatisfied, and sold his interest to Frank Searight at a small loss. Subsequent to that I went to Mr. Schardt's house to see him, having heard again that he was speculating. I told him what I had heard, and he said that it was not so; that he did not own any stocks at all. I told him if he was he ought to quit that or quit the Bank, and he said he had sold everything he had. I again heard that he was speculating, but from sources that I did not attach any importance to, as it all emanated from the same source as the anonymous letter. I again approached him, and he denied it.

Testimony of Theo. Cooley.[1]

Q. 3. Did the defendant Company at any time cancel its bond on John Schardt while he was cashier of the complainant company? If so, when, and for what reason?

A. Yes, sir; the Company did cancel its bond through me, as its agent, the Saturday before the Bank assigned on Monday. The cause which led to this action was that I had ascertained that John

[1] Trans., p. 98.

Schardt had been speculating in futures, and I so reported to the Bank when the bond was canceled.

Q. 9. Did you know or hear of Schardt's speculations prior to the time mentioned above when you received such information?

A. I did not.

Q. 10. Have all matters pertaining to the issuance of the bonds upon Schardt in favor of the complainant passed through your hands as representative of the Company?

A. They have, so far as I know.

Q. 11. Is it or not a part of your duties to gather information concerning applicants for bonds, and about persons already bonded in the defendant Company, in this part of the country?

A. Yes, sir.

Q. 12. Do you transmit such information to the home office of the Company?

A. I do.

Q. 13. If the Company had received any information with respect to Schardt's speculations, or other information unfavorable to him, would you have been advised of the fact by the Company?

A. I would, as that is the usual method of doing business.

All of the above testimony was brought out by counsel for the Company, and not one question, direct or indirect, was asked by counsel for the Bank of any one of these or other witnesses, to either contradict or vary what had been brought out by counsel for the Company upon this question of speculation. Whatever was developed along this line for the Company was allowed to rest without any effort to vary or contradict the same.

No information concerning this speculation was, at any time, furnished the Company or its agent at the place where the Bank was located.

BANK BOOKS.

There was kept in the Bank an individual ledger, which showed in detail the deposit account of each depositor. This book was kept by a clerk who had no other duties, and was known as the "individual bookkeeper." Schardt had nothing to do with the keeping of this book. There were three other books, all kept by Schardt: (1) A general ledger, showing generally the accounts of the Bank, including the total deposits, but not in detail the accounts of depositors. There was kept in this book an account of demand loans, discounts, bonds, stocks, etc. It purported to show the total deposits paid in and those checked out each day, *and purported to show at the end of each day's business the aggregate amount due to depositors.* (2) A daily balance book, which showed a summary of each account in the general ledger. It showed on each page, at the end of each day's business, all the assets and liabilities of the Bank under appropriate heads; it showed the amount of notes, cash, stocks, bonds, etc., owned by the Bank, and the amount the Bank owed *depositors*, other banks, bills payable, etc.[1] (3) A cash book, in which each day's business was grouped on one page, instead of putting the business of each day under the various accounts, as in the general ledger, each page of the cash book showing the entire business transacted that particular day, each page beginning with the cash on hand at the opening of the Bank any particular day would be debited with all the receipts for the day, and showing from what source derived, and would be credited with all disbursements and showing on what account made.[2] These were the principal and only material books kept in the Bank.[3]

The aggregate amount due depositors on the individual ledger, and the general ledger balance, showing the amount due depositors, should at all times have agreed, the individual ledger showing the amount due *each* depositor, and the general ledger the aggregate amount due *all* depositors.[4] These balances were compared

[1] Trans., p. 43.
[2] Trans., pp. 44-5.
[3] Dep. McEwen, cross-q. 4, Trans., p. 35.
[4] Dep. Boench, q. 9, Trans., p. 76.

and made to agree as often as every thirty days, until just before Schardt commenced to abstract money, in the latter part of 1890. After that time no comparisons were ever made,[1] although it is customary in all banks to have them made as often as every thirty days.[2]

The individual and general ledger were out of balance January 16, 1891, $2,098; January 1, 1892, $19,600, and on January 1, 1893, $69,700.[3]

The individual ledger was properly kept, and correctly showed the amount due to each depositor.[4]

The general ledger was not properly kept, and after the latter part of 1890 did not correctly show the amount due to depositors. It was not correct because Schardt, as teller, abstracted the funds of the Bank, and understated on the general ledger the amount due to depositors by the amount he had abstracted to that date. And the difference in the balances represented a shortage by Schardt of that amount at the respective dates.[5]

On April 15, 1893, the Bank employed an accountant to examine Schardt's books.[6] He, by merely comparing the individual and general ledger balances, ascertained and reported the embezzlement to the Bank.[7]

Schardt also abstracted proceeds of notes paid to him as teller. His books were not falsified to conceal this character of shortage, but the amount of notes in the Bank did not equal the amount called for on Schardt's books by the amount he had abstracted. This character of shortage continued for three years prior to the assignment.[8]

On January 1, 1892, when the Bank procured a renewal of the teller's bond by representing to the Company that his books and

[1] Dep. Boench, q. 6, Trans., p. 75.

[2] Dep. Fischer, q. 4, Trans., p. 88; Dep. Duncan, q. 12, Trans., p. 83; Dep. McLaughlin, q. 5, Trans., p. 80; Dep. Harris, cross-q. 4, Trans., p. 74.

[3] Dep. McEwen, cross-q. 43, Trans., p. 42.

[4] Dep. McEwen, cross-q. 42, Trans., p. 42.

[5] Dep. McEwen, cross-q. 24, Trans., p. 39.

[6] Dep. McEwen, cross-q. 1, Trans., p. 35.

[7] Dep. McEwen, cross-q. 5, Trans., p. 36.

[8] Dep. McEwen, cross-q. 37 and 43, Trans, p. 41, 42.

accounts had been examined and *verified*, the bank books kept by Schardt showed that he was a defaulter for $23,169.34; of this shortage $19,600 was abstracted deposits, and $3,765.44 proceeds of notes collected and not accounted for, as shown on the books of the Bank.[1] On January 1, 1893, when Schardt was made cashier, and the bond on him as such was procured to be issued, by the Bank representing to the Company that his books and accounts had been *examined* to that date and found *correct*, his shortage was $78,819.24; of this amount $69,700 was abstracted deposits, and $4,015.44 proceeds of notes collected, all of which was apparent upon the books of the Bank.[2] The capital of the Bank was $50,000.[3]

[1] Dep. McEwen, cross-q. 43, Trans., p. 42.
[2] Dep. McEwen, cross-q. 43, Trans., p. 42.
[3] Dep. Eatherly, q. 11, Trans., p. 51.

ASSIGNMENT OF ERRORS.

TELLER'S BOND.

1. The Bank agreed to immediately notify the Company on becoming aware of the employe being engaged in speculation, and the Bank learned that the employe had not only been speculating, but had been part owner in a gambling concern, and neither investigated the matter on its own account, nor notified the Company.

2. The Bank procured the teller's bond to be renewed in January, 1892, by representing that the employe's books and accounts had been examined and *verified*, when the *books of the Bank showed a default of* $23,365.44, in a bank with a capital of only $50,000.

3. The Bank agreed to "observe, or cause to be observed, all due and customary supervision over the said employe *for the prevention of default*," and during the currency of the bond ceased to compare ledger balances, or correctly count the notes held by the Bank, which was not only customary with other banks, but was customary in this Bank up to the time this shortage commenced.

4. The bond provided that there should be "an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months," yet the ledger balances were not compared, and the notes in the Bank were not counted or compared with the amount called for by the books; every page in the books kept by him was incorrect; and no inspection or audit of his books or accounts was made.

CASHIER'S BOND.

1. The Bank represented that it did not know of and had not "heard of anything unfavorable as to the habits or associations, past or present," of the employe upon whom it was seeking the issuance of the bond; yet at the time the Bank, *and the particular officer, making the statement for the Bank, knew* that the employe had been engaged in speculation, and had been a partner in a gam-

bling concern, while occupying a position of trust in the Bank, and no effort was made to verify his statement that he had sold out his interest in the "bucket shop" and had ceased speculating.

2. The Bank procured the issuance of the cashier's bond by representing that the books and *accounts* of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet at that time the *books of the Bank showed a default* of $73,715.44, in a bank with a capital of only $50,000.

3. The Court allowed $5,992.35 of overdrafts "allowed but not authorized," as a part of the default for which the Company was liable, although the bond only protected the Bank against a default "constituting embezzlement or larceny."

BRIEF AND ARGUMENT.

I.

GENERAL PRINCIPLES.

The Supreme Court has quite recently announced the rules of construction applicable to this form of insurance contracts:

*If, looking at all its provisions, the bond is *fairly* and *reasonably* susceptible of two constructions, one favorable to the Bank and the other favorable to the Surety Company, the former, *if consistent with the objects for which the bond was given,* must be adopted, and this for the reason that the instrument which the Court is invited to interpret was drawn by the attorneys, officers or agents of the Surety Company. This is a well established rule in the law of insurance. *National Bank* v. *Insurance Co.*, *95 U. S., 673; Western Ins. Co.* v. *Cropper, 32 Penn. St., 351, 355; Reynolds* v. *Commerce Fire Ins. Co., 47 N. Y. 597, 604; Travelers' Ins. Co.* v. *McConkey, 127 U. S., 661, 666; Manchester, etc., Life Ass'n, 3 B. & S., 917, 925.* As said by Lord St. Leonards in *Anderson* v. *Fitzgerald, 4 H. L. Cas., *483, *507,* "it [a life policy] is of course prepared by the company, and if therefore there should be any ambiguity in it, must be taken, according to law, most strongly against the person who prepared it." There is no sound reason why this rule should not be applied in the present case. The object of the bond in suit was to indemnify or insure the Bank against loss arising from any act of fraud or dishonesty on the part of O'Brien in connection with his duties as cashier, or with the duties to which in the employer's service he might be subsequently appointed. That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the Company *if* there be another construction *equally* admissible under the terms of the instrument executed for the protection of the Bank.

American Surety Co. v. Pauly, 170 U. S., 133.

In *Travelers' Insurance Co.* v. *McConkey* (*ibid*) it is said:

Such being the contract, the Court must give effect to its provisions according to the *fair* meaning of the words used, leaning, however — where the words *do not clearly* indicate the intention of the parties — to that interpretation which is most favorable to the insured.

*Italics added.

To these rules of construction, natural and reasonable as all must admit, no criticism can be made. However, Courts will not speculate upon what particular words and phrases may or might mean, where there is a natural and usual meaning attached to them, easily understood, and not *fairly* and *reasonably* susceptible of two constructions, and *clearly* indicating the intention of the parties.

Whatever conditions are contained in the contract will be upheld and enforced by the Court:

In *Imperial Insurance Co.* v. *County of Coos,* 151 U. S., 452, Mr. Justice Jackson delivering the opinion, says:

> Contracts of insurance are contracts of indemnity upon the terms and conditions specified in the policy or policies embodying the agreement of the parties. For a comparatively small consideration the insurer undertakes to guaranty the insured against loss or damage upon the terms and conditions agreed upon, and upon no other; and when called upon to pay, in case of loss, the insurer, therefore, may justly insist upon the fulfillment of these terms. If the insured can not bring himself within the conditions of the policy he is not entitled to recover for the loss. The terms of the policy constitute the measure of the insurer's liability, and in order to recover, the assured must show himself within those terms; and if it appears that the contract has been terminated by the violation, on the part of the assured, of its conditions, then there can be no right of recovery. The compliance of the assured with the terms of the contract is a condition precedent to the right of recovery. If the assured has violated or failed to perform the conditions of the contract, and such violation or want of performance has not been waived by the insurer, then the assured can not recover. It is immaterial to consider the reasons for the conditions or provisions on which the contract is made to terminate, or any other provision of the policy which has been accepted and agreed upon. It is enough that the parties have made certain terms conditions on which their contract shall continue or terminate. The Courts may not make a contract for the parties. Their function and duty consist simply in enforcing and carrying out the one actually made.

The contract should be read in the light of the purpose for which it was made, and the statements and acts of the parties in the light of the surrounding circumstances.

This Court knows judicially that the most prudent and conservative financial institutions, exercising the strictest supervision, require their employes occupying positions of trust to be bonded against any fraudulent conduct involving a loss to the institution.

No supervision, however careful or thorough, can prevent losses of this character. No system of keeping accounts, or examinations, can eliminate this risk. The most that can be expected is to discover the fraud before the loss becomes serious. Hence it is that only bonds for sufficient amounts to cover this character of risks are required and accepted. The amount of the bond is but a small percentage of what the employe may have access to in the usual course of his employment, but by exercising due and customary supervision, and with a proper system of examinations, the chance of any default becoming serious before discovery is minimized. Experience teaches that honest men rarely become dishonest in a day. Temptation, when first encountered, is easily resisted; with each succeeding encounter the power of resistence is weakened. Defaults are small in the beginning, and gradually increase to enormous amounts, if not sooner detected. Persons of experience and observation have found that persons in positions of trust who speculate in stocks, grain, cotton, provisions, and like commodities, invariably, lured on by the hope of retrieving past losses, become defaulters to large amounts. They have further found that persons in positions of trust who are in the habit of gaming will, sooner or later, become losers, and, in consequence, defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculations involving sums far greater than those at risk on games of hazard. They have found that when an employe has once yielded to temptation and defaulted, he is likely to again default. They have found that persons in positions of trust who live beyond their income, are likewise greatly exposed to the temptation of small peculation, particularly if addicted to immoralities and other excesses. They have found that a man's daily habits and associations determine very largely the likelihood as to whether or not he will continue the faithful discharge of his duties. They have further found that outside of and beyond these personal elements, the character of the supervision over the employe *for the prevention of default*, and the probability or improbability of an early discovery of any shortage, is a factor of the highest importance in determining whether or not it is likely that an employe will be guilty of his first embezzlement.

The largest defalcations are usually followed by statements from the unfaithful employe's superior officers that he was a too much trusted employe, who had been abstracting the funds intrusted to him for years.

Financial institutions do not procure bonds of suretyship to take the place of the duties incumbent upon the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of keeping accounts.

The interest of the Bank and the Surety Company is identical. Each is interested and seeks to prevent a default; each is interested in the character of the supervision, and the lack of opportunity for default, and especially discovery before it becomes serious.

It is difficult to understand just how *any* conditions or provisions in such bonds having for their purpose the prevention of a default, or the detection of the same at the earliest possible time, and before it assumes any magnitude, are detrimental to the Bank accepting such bonds. Upon the contrary, it would appear to be more to the advantage of the Bank than the Company, as shown in the case at bar, the bond being an indemnity for only $10,000, while the default was more than $73,000. If the making of inquiries concerning the condition of the books of the employes results in requiring the Bank to make examinations to ascertain the information, this is more to the interest of the Bank than the Company, because any irregularities developed by such examinations should be known by the Bank.

Hence, all the conditions of the contract which merely require of the Bank what should be done without requirement, should commend themselves to the Court, and receive a fair and reasonable construction, looking to the intention and purposes of the contracting parties, and the contract as written.

Certain it is that no harsher or stricter rule should be applied in such cases than is applied in cases of other insurance, and particularly in cases of marine and fire insurance, which are very similar to suretyship or guarantee insurance in regard to the opportunity of information concerning the risk incurred. The rules governing life insurance should be administered even more strictly than in

suretyship insurance, for the reason that controversies regarding life insurance, involving the representations made to procure it, and the covenants regarding acts to be done on the part of the person whose life is insured, ordinarily do not arise until after the death of the person whose life is insured, and his representatives are cut off from the benefit of his testimony. In the case of suretyship insurance, when a claim for a loss has been made, both parties stand on an equal footing, regarding their knowledge and ability to testify as to the representations made and the performance of the covenants put on the person holding the insurance.

In fire and life insurance, the insured is frequently ignorant and unused to dealing with a more experienced man, able to take advantage of his ignorance. It frequently happens that, in such insurance, the insured is financially weak, and carries on an unequal struggle with an opulent opponent. In suretyship insurance, as a rule, the contrary is true. Persons and managers of corporations seeking such insurance are usually shrewd business men, abundantly able to take care of themselves in contracting, and ordinarily careful to know the terms of a contract, and scrupulous to see that they fulfill their part. In any suit that may arise with a guarantee company, they have ample resources, so as to leave nothing in their favor undeveloped.

Nor should too close a comparison be made between these *contract* bonds and bonds written for governments upon public officials. In the former the terms are mere matter of contract between private concerns. The risk assumed and the terms and conditions of the bond finally accepted is the result of negotiation between the contracting parties, each insisting upon such terms and conditions as appear desirable. Upon the contrary, public bonds, taken by surety companies, are not subject to change by contract, or otherwise; the law prescribes the exact terms of the bond, the character of supervision, and other safeguards for the prevention of default which inure to the benefit of the surety company without specific agreement therefor being inserted in the bond. In the one case the parties make their own agreement, in the other the law makes the agreement, which the surety company must accept or decline as tendered.

An examination in this case of the applications for, and the language of the bonds themselves, will show a purpose to make only a prudent inquiry into the surroundings of the employe, his opportunities for frauds, and the experience of the Bank with him preceding the application for the bond. The only conditions imposed are good faith and the exercise of such control and supervision of the employe, and examination of books and accounts, *for the prevention of default*, as would naturally be expected from reasonably well managed institutions without any requirement. These and similar requirements and conditions should be liberally construed and strictly enforced in the interest of a sound public policy.

II.

REPRESENTATIONS BY OFFICERS BINDING UPON THE BANK.

The representations of the president and cashier as to the examination of the employe's books and accounts, and with respect to the previous conduct of the employe were made for the Bank, and are binding upon it.

What is said by the Court in *American Surety Co.* v. *Pauly*, 170 U. S., 133, with respect to the representations of the president not being within the scope of his duties, makes it necessary to point out the distinction between that case and the case at bar.

In that case it was ruled that the act of the president, in certifying to the integrity, efficiency, and fidelity of the cashier, was not the act of the Bank, for two reasons. (1) It was no part of the duties of the president, and therefore he is not presumed to have disclosed to the Bank what he had done. (2) He and the cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the Bank, and hence is not presumed to have notified the Bank of what he had done. In that case the bond did not refer to the statement of the president, it did not appear that the Bank procured the bond, and it was not shown that the Bank was aware of representations made by the president. In the case at bar the facts are wholly different. There is no con-

tention in this case that either the president or cashier were the confederates of the bonded employe.

The cashier's bond refers specifically and accurately to the representations of the president; they are made a part of the bond, and it is recited that the statements are made on behalf of the Bank. The language of the bond is:

> "Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' *on behalf of the said employer,* and lodged with the said Company at its office in Montreal, . . . do hereby . . . covenant with the said employer to reimburse unto the said employer."[1]

The teller's bond was not renewed until the *Bank* complied with the conditions imposed by the Company, which was thus stated to the *Bank:*

> "It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."[2]

The premium for each bond was paid by the Bank, and it was so represented to the Company in each instance before the bonds were granted. In this case the Bank procured each bond, and had knowledge that the representations had been made for it by its proper officer. As long as the bonded employe was teller, these representations were made by the cashier. When he was elected cashier, the representations concerning him were necessarily made by the president.

[1] Trans., p. 7.

[2] Trans., p. 106.

As to the teller's bond, the *Bank* desired a renewal, and the Company declined to grant a renewal *until* the *Bank* should certify the result of the examinations made concerning the employe's books and accounts, and thereupon the Bank did make the representations through its cashier.

As to the cashier's bond, the contract made the statements of the president a part of the consideration, and stated that the representations of the president were made on *behalf of the bank.*

In the *Pauly* case the Court says:

> The presumption that the agent informed the principal of that which his duty and the interest of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends, or to commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent *unless* it be proved that he had at the time actual notice of them, or having received notice of them, failed to disavow what was assumed to be said and done in his behalf.

In this case, if the president exceeded his authority, and if his representations were beyond the scope of his duties, still the Bank had actual knowledge of his acts, and did not disavow what was assumed to be said and done on its behalf.

The language of the bonds in this case show clearly dealings between the Bank and the Company for the issuance of the bonds, and they are, in fact, contracts resulting from negotiations between the Bank and Company, and in which contracts the employe joins.

In the case at bar it is shown that the *Bank*, and not the employe, procured the suretyship bonds. The negotiation for them was between the Bank and the Company. This Court said in the *Pauly* case that these suretyship contracts are insurance contracts. If the Bank procures insurance upon its banking house against loss by fire, storm, or other contingency, it would certainly be within the scope of the officers' duties to make representations with respect to pertinent inquiries concerning the building. And if the Bank procures a contract of insurance against loss resulting from the fraudulent acts of its employe, it is equally within the

scope of the officers' duties to answer pertinent inquiries concerning the Bank's affairs and the employe. The Bank entered into the contract with the Company, and representations by its officers to the Company, which induced the making of the contracts, are clearly binding upon the Bank.

It is, therefore, confidently asserted that the question of the Bank's responsibility for the representations of its cashier and president, in procuring these contracts of indemnity, can not be the subject of dispute.

III.

SPECULATION.

The teller's bond was breached by the Bank in not reporting the speculation and disreputable habits of the bonded employe; and the cashier's bond was procured by a material misrepresentation as to his habits and associations.

This question of speculation is common to each bond, but applies in a somewhat different form. The teller's bond required immediate notice to the Company of the "employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits." The Bank procured the issuance of the cashier's bond by representing that it had not heard of and had not known of "anything unfavorable as to the habits or associations, past or present, of the employe." In the summer of 1892, during the currency of the teller's bond, and preceding the issuance of the cashier's bond in January, 1893, the Bank was told that the employe was speculating, and was a part owner in a "bucket shop." This information was confirmed to the Bank by the admission of the employe, and from other sources. The employe was told by a director and member of the finance committee of the Bank that "he ought to quit that or quit the Bank." The president of the Bank knew that the employe was afflicted with the fever of speculation, and still retained him in the employ of the Bank, without any investigation and without notice of the facts to

the Company, and induced it to issue the cashier's bond by withholding this information.

The former opinion of this Court thus states the facts:

> It is in evidence that information came to the president and directors of the Bank, through their cashier, that Schardt was a partner in what was called "a bucket shop," an agency for promoting speculation in small amounts upon the fluctuations of stocks, grain, cotton, and other commodities in which speculative gambling is done, and that he himself was speculating. When charged with this, Schardt admitted that he had taken an interest in such a partnership, but that he had sold out. He called his former partners to confirm his statement in this regard. He also admitted, according to one of the witnesses, at another time, that he had speculated to some extent, but asserted that he had always made gains and had seen the error of his ways and had stopped. Subsequently the cashier received an anonymous letter stating that Schardt was still speculating. He informed the president of the Bank. Schardt said it was a lie and no more attention was paid to it. All this occurred prior to the time when the president signed the guarantee proposal for the cashier's bond referred to. As a matter of fact, Schardt was speculating all the time, and lost the $100,000 he had stolen in gambling in futures.

The Circuit Judge thinks these facts, "when brought to the attention of the Bank officials, were a past event, and *apparently in itself unimportant.*" This Court had an "impression that this defense rests on circumstances *comparatively inconsequential.*" The Court further says: "There is no proof that Schardt ever confessed to speculation or gambling, except that of Sykes, who is somewhat discredited because he has a litigation with the Bank and an apparent animosity toward it." Eatherly, a director, and member of the finance committee of the Bank, interested financially with the Bank in this litigation, and called to testify for the Bank, says: "Subsequent to that, I went to Mr. Schardt's house to see him, having heard *again* that he was speculating. I told him what I had heard, and he said it was not so, that he did not own any stocks at all. I told him that if he was he ought to quit that, or quit the Bank, *and he said that he had sold everything he had.*"[1]

The statements of Sykes were not disputed, although he gave the names of all the parties, including the president of the Bank, who was not called to contradict Sykes.

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[1]Trans., p. 61.

Nor is it true that Sykes *thereafter* recommended him to the Company for a renewal of the teller's bond, or to the Bank as a suitable person to be his successor. The last renewal of the teller's bond was in January preceding; and Sykes merely stated, in reply to an inquiry, that Schardt had the *ability* to perform the duties of cashier. Nothing was asked or said with respect to his character.[1]

All these facts concerning the speculation of the employe were developed by the company. The able counsel for the Bank deemed it best for the Bank to wholly refrain from either introducing other witnesses to contradict what had been developed, or even to test the accuracy of what these witnesses stated. This resulted from no lack of interest in the question or want of ability. The name of the counsel representing the Bank is sufficient evidence of this fact. He, no doubt, was fully impressed with the idea that the least said was the best for his client, and that any effort to destroy the force of what the Company had developed could but make it stronger.

When the case was remanded to the Circuit Court, the Company filed a petition seeking to reöpen the case for further evidence upon this question of speculation, but the Court sustained the objection of the Bank, and declined to allow any further evidence.[2]

This question of speculation by an employe having the custody of trust funds, and the duty of the employer in such cases, is not a new one to the Courts.

PRESTON v. PRATHER.

137 U. S., 604.

This case involved the liability of a bank for the loss of bonds abstracted by its assistant cashier. The bank was held guilty of gross negligence, and liable as a gratuitous bailee, under the facts thus stated in the opinion of the Court:

It was shown that, about a year before the assistant cashier absconded, the defendant, Kean, who was the chief officer of the banking institution,

[1] Dep. Porter, cross-q. 7, Trans., p. 80.

[2] Trans., pp. 112, 117.

was informed that there was some one in the bank speculating on the Board of Trade at Chicago. Thereupon Kean made a quiet investigation, and the facts discovered by him pointed to Ker, whom he accused of speculating. Ker replied that he had made a *few transactions*, but was doing nothing then, and did not propose to do anything more, and that he was then about a thousand dollars ahead, all told. It was not known that Ker had any other property besides his salary. His position as assistant cashier gave him access to the funds as well as the securities of the bank, and he was afterwards kept in his position without any effort being made on the part of the defendants to verify the truth of his statement, or whether he had attempted to appropriate to his own use the property of others.

Again, about two months before Ker absconded, one of the defendants, residing at Detroit, received an anonymous communication stating that some one connected with the bank in Chicago was speculating on the Board of Trade. He thereupon wrote to the bank, calling attention to the reported speculation of some of its employes, and suggesting inquiry and a careful examination of its securities of all kinds. On receipt of this communication, Kean told Ker what he had heard, and asked if he had again been speculating on the Board of Trade. Ker replied that he had made some deals for friends in Canada, but the transactions were ended. The defendants then entered upon an examination of their books and securities, but made no effort to ascertain whether the special deposits had been disturbed. Upon this subject, the Court below, in giving its decision (29 *Fed. Rep.*, 498), after observing that the defendants knew that Ker had been engaged in business which was hazardous, and that his means were scant, and, after commenting upon the demoralizing effect of speculating in stocks and grain, as seen in the numerous peculations, embezzlements, forgeries, and thefts, plainly traceable to that cause, and the free access by Ker to valuable securities, which were transferable by delivery, easily abstracted and converted, and yet he being allowed to retain his position without any effort to see that he had not converted to his own use the property of others, *or that his statements were correct*, held that it was gross negligence in the defendants not to discharge him or place him in some position of less responsibility. In this conclusion we fully concur.

The exact language of Judge Gresham, thus approved by the Court, is:

It is immaterial, however, whether the defendants were bailees with or without reward, as in either case they are liable for the value of the bonds, the loss having resulted from their gross negligence. The defendants knew that Ker had been engaged in business which was hazardous, and that his means were scant. The demoralizing effect of speculating in stocks and grain — more properly speaking, gambling on the rise and fall of the price of stocks and grain — is seen in the numerous peculations, embezzlements, forgeries, and thefts plainly traceable to that cause. Ker had free access to valuable securities, which were transferable by delivery, easily

abstracted and converted; and yet he was allowed to retain his position without any effort to see that he had not converted to his own use the property of others, or that his statements were correct. A prompt examination, after his first admission that he had been speculating, would have doubtless shown that even then some of the plaintiff's bonds had been exchanged for others, if, indeed, they had not been stolen. Ker's position was one of trust and great importance. *His own admission showed that he was not trustworthy for such employment*, and it was *gross negligence* in the defendants not to discharge him, or place him in some position of less responsibility.

Prather v. Kean, 29 Fed. Rep., 502.

In *Scott* v. *National Bank of Chester Valley*, 72 Pa., 479, the fact that the employe was suffered to remain in the employ of the bank, after it was known that he had dealt *"once or twice"* in stocks, called forth the following language by the Court:

No officer in a bank, engaged in stock gambling, can be safely trusted, and the evidence of this is found in the numerous defaulters whose peculations have been discovered to be directly traceable to this species of gambling. A cashier, treasurer, or other officer having the custody of funds, thinks he sees a desirable speculation, and takes the funds of his institution, hoping to return them instantly, but he fails in his venture, or success tempts him on, and he ventures again to retrieve his loss or increase his gain — and again and again he ventures. Thus the first step, often taken without criminal intent, is the fatal step which ends in ruin to himself and to those whose confidence he has betrayed. Hence, *any* evidence of stock gambling or dangerous outside operations, should be visited with *immediate dismissal.*

This language was quoted with approval by the Court, in *Preston* v. *Prather* (*ibid*), and all these cases are referred to with approval by the Court of Appeals in Illinois.

Gray v. Merriam, 148 Ill., 179.

See also,

Merchants' Nat. Bank v. Guilmartin, 93 Ga., 503.

This subject of speculation has received the consideration of the Legislature and the Courts of Tennessee.

By Chapter 251, Acts of 1883, it is enacted:

That hereafter any sale, contract, or agreement for the sale of bonds, stock, grain, cotton, or other produce, property, commodity, article, or

thing for future delivery, when either of the contracting parties, buyer or seller, is dealing simply for the margin, or on the prospective rise or fall in the price of the article or thing sold, and when either of said contracting parties have no intention or purpose of making actual delivery or receiving the property or thing in species, shall be deemed, and is hereby declared, gambling.

Since 1883, a heavy license tax has been imposed upon such business, and in 1895 the tax was made $50,000 per annum.

In *Palmer & Cartwright* v. *State*, 88 Tenn., 553 (1889), it is held that the license tax does not legalize or protect the business from the criminal laws of the State, citing License Tax Cases, 5 Wall, 462, but is an additional burden upon the business.

In *McGrew* v. *City Produce Exchange*, 85 Tenn., 578, the Court, in construing the Act of 1883, above quoted, said:

This Act was intended to make it unlawful if either party had no intention of effectuating a real purchase or sale. It was designed to suppress the evil of dealing in futures, and to limit such operations to *bona fide* sales and purchases by those who wished to sell to those who intended to buy. In making the seller responsible for the intent of the buyer, and the buyer responsible for the intent of the seller, it intended to suppress gambling by confining the business of buying and selling for future delivery in such limits as would practically preclude the possibility of it. The *bona fide* dealer can still operate, but he can not do so upon any terms which do not protect the community against the pernicious and ruinous speculation in the rise and fall of prices.

ALLEN v. DUNHAM.

92 Tenn., 257.

In this case it appears from the opinion of the Court that Allen was teller in a Nashville bank, where the defendant in error was located. In May, 1890, he purchased, among other things, $90,000 of securities in one of these "bucket shop" concerns, but in the name of and through his outside friend, Dismukes. He became a defaulter and transferred his claim to recover money lost at gambling in this "bucket shop" to the bank, to secure his embezzlement. The bank thereupon sued the "bucket shop," and in the opinion of the Supreme Court, delivered at the December Term, 1892, after quoting what is above copied from the opinion in *McGrew* v. *City Produce Exchange*, it is said:

We add to what has already been so well said, that there is no evil more demoralizing and pernicious in its tendencies and consequences than the spirit of reckless speculation which pervades so largely all sections of our country, and all classes of society. It inevitably leads to peculation, embezzlement, and other crimes. It crushes legitimate business, and creates an unhealthy excitement, which brings ruin as its result. . . .

Now, what facts are developed in this case? We have a young man occupying an honorable and responsible position as bank teller, intrusted with the funds of the bank and its customers. Possessed with an unnatural desire to grow rich suddenly, he finds these defendants offering to him a field which he can enter for a comparatively small sum, and thereby become the ostensible owner and controller of stocks to an almost unlimited amount, subject to daily fluctuations, which, if favorable to him, would in one day realize for him more than he could earn in a year of hard labor at his legitimate work. Is it any marvel that he is induced to enter the inviting field?

It thus appears that at the time the defendant in error was receiving confessions from *its* teller that he was speculating and running a "bucket shop," and declining to notice anonymous communications warning them of his conduct in this respect, the example of a blighted life and a ruined institution, all caused by the speculation of a teller, was being rehearsed in the Courts in the same city; and the president of this Bank, with this startling example of the ruin and disgrace which inevitably follows in the wake of an employe handling trust funds and speculating, not only declines to heed the warnings of anonymous letters following the confession of the employe, but makes no investigation of the matter, gives no warning to the surety as required in the bond, and then represents that he has *never heard of anything unfavorable, past or present,* of this speculator and "bucket shop" dealer. He is not called to explain or deny any of these facts. He is not called to testify as to his honesty or good faith in this matter, and *yet* the Court trying this case has apparently attributed to him *both* honesty *and* good faith. No bank president, standing in the shadow of facts disclosed in the case of *Allen* v. *Dunham* (*ibid*), having knowledge of facts disclosed in this record, can be credited with having acted honestly or fairly with the surety Company in not reporting the speculation, as required in the teller's bond, and in representing such an employe worthy of confidence.

In the case at bar the confessed acts of the bonded employe

were far more serious than those of the employes in the above cited cases. Here the employe, without means, upon a salary of $100 per month, with his entire business career in the Bank, not only admitted having "speculated to some extent," but that he had, while teller of the Bank, become part owner of a "bucket shop," which is not merely acting as agent for others, but is the taking of all bets tendered by the public. *Allen* v. *Dunham* (*ibid*). It is the most demoralizing and the most vicious form of all speculation. And if it be gross negligence and want of good faith in a bank not to discharge an employe confessing to have made a "few deals," what will be said of the action of a bank retaining in its service an employe confessing to having speculated to some extent, and to having been part owner of a "bucket shop"? What process of reasoning can make it good faith upon the part of the president of the bank, possessed of such information, who represents to a proposed surety, that he has never heard or known of *anything* unfavorable concerning such an employe? How can good faith be accorded to the managing officers of a bank, who fail to report such knowledge of speculation and indulgence in such a disreputable pursuit as speculation and part ownership in a "bucket shop," when the bank is under contractual obligation to report such conduct to the surety of such an employe? How can any Court deem such information "apparently in itself unimportant"?

The Circuit Judge thinks that the *extent* of the speculation was not sufficient to require notice to the Company, and the Court of Appeals rather discredits the direct and positive evidence of Sykes, a witness unimpeached, uncontradicted, and sustained, if not by direct and positive testimony, certainly by circumstances of the greatest weight and importance. Eatherly, a director, and a member of the finance committee of the Bank, a witness offered by the Bank and interested in this litigation, says that Schardt told him in the presence of Baxter, the president of the Bank, that he had been part owner in a "bucket shop"; and on another occasion admitted that he had been speculating. It is not unreasonable that Sykes should have received the same information, aside from his positive and uncontradicted testimony.

The Court refers to the failure of the local agent of the Company to learn of the speculation of Schardt. What can be said of the action of the Bank in failing to discover the truth, having the knowledge of facts that made an investigation imperative, if neglect be attributable to the agent of the Company in not discovering the truth, who had no suspicion of the matter? The word of the employe was accepted by the Bank for the truth of the statement that he had ceased to speculate, without any independent investigation being made. The Company was deprived of the opportunity of making any investigation because of the failure of the Bank to give notice to the Company, as required by the bond, of the information it had.

With respect to the cashier's bond, the Company certainly had the right to know of this speculation and "bucket shop" dealing, when the president of the Bank was asked about the employe. If the confession of the employe to having made a "few deals" made it the imperative duty of the bank to discharge him; if it was gross negligence and bad faith in the bank to have retained him in a position of trust, how much the greater was the duty to discharge, and the bad faith in retaining him, when, in addition to the confession of a "few deals," the employe confessed to having had an ownership in a "bucket shop"? Was not this information unfavorable? Was it not discrediting? Can *any* bank president truthfully represent "to the best of his knowledge and belief," that he has not known of or heard of anything unfavorable of such an employe?

It was a breach of the written contract voluntarily entered into between the Bank and the Company in the case of the teller's bond, and a material misrepresentation in procuring the cashier's bond.

Beyond and above any amount of speculation as to why the Bank acted as it did, the fact remains that the Company desired to know of any speculation upon the part of the bonded employ, and hence stipulated for it; and the Bank breached the stipulation in not imparting the information it had.

As to the statement of the president that he had never heard of anything unfavorable as to the employe, which statement in-

duced the issuance of the cashier's bond, it is certain that he *had* heard of matters during the preceding year, which rendered the employe unworthy of confidence and demanded his immediate discharge. It is wholly immaterial why the president did not impart this information. He did, in fact, withhold the information which he had and was requested to give, and he is not called as a witness to explain his conduct, nor is any reason offered for not doing so.

Both the letter and spirit of the suretyship contracts were violated in this question of speculation and "bucket shop" dealings. The condition of the teller's bond was a reasonable one, having for its purpose the protection of the Bank as well as the Company. To construe it into a meaningless jumble of words, or into meaning such an improbable thing as notice only when the employe is apprehended in the very act of making a speculative deal, would not be in keeping with the ordinary meaning of the words used, nor the purpose had in view by the Bank and the Company in the making of this condition of the contract.

And the representation of the Bank's president that he had not heard of anything unfavorable as to the employe, can not be explained away upon any possible theory consistent with veracity, good faith, or a fair understanding. If, as this Court has said, it be *bad faith* to merely retain an employe in the service of the bank who has been speculating "to some extent"—"made a few deals," how can it be called *good faith* in one knowing such facts, and the additional fact of ownership in a "bucket shop," to represent that he knows nothing, past or present, unfavorable concerning the employe? Nor should the Court be called upon to invent an escape from the plain imputation of bad faith for Baxter, who, although accessible, is not called to explain for himself. If the Bank's counsel did not attempt to *explain* away this evidence with other witnesses, why should the Court endeavor to *reason* it away?

The representation of Baxter was in his official capacity, and for the benefit of the Bank in the scope of his duties, and is, therefore binding upon the Bank. The representation was material, and was false. The contract obtained under it can not be en-

forced. If the statements of the president were not authorized by the Bank, and were not in the apparent scope of his authority, the Bank adopted and ratified his act. The bond recited that the Company relied upon the statement of the president and specially referred to it as a part of the contract, and recited that the bond should be void upon the misstatement of a material fact.

It is universally held that when an employer knows the employe has been guilty of dishonest conduct, and conceals the information from the contemplated surety, the bond is void, whether inquiry be made by the intended surety or not.

Smith v. Bank of Scotland, 1 Dow., 294.
Phillips v. Foxall, L. R., 7 Q. B., 666.
Franklin Bank v. Cooper, 36 Me., 179.
Franklin Bank v. Stevens, 39 Me., 532.
Wayne v. National Bank, 52 Pa., 343.
Bostwick v. Van Voorhis, 91 N. Y., 353.
Clark v. Mfg. Ins. Co., 8 How., 335.

The reason assigned in all these cases is, that it is so little to be expected that an employer would continue in service such an employe, that it amounts to holding him out as a person of trust, and that this amounts to a fraud. If there be any unusual matter affecting the risk which the insured knows and the insurer may be ignorant of, then the information must be volunteered, even though not inquired about.

It is not necessary to go to that extent in this case, because here the direct inquiry was made by the Company,[1] and the answer made a part of the contract.[2] Hence, if the Bank concealed information or misrepresented what, if known, would have materially affected the risk, the contract is avoided. In this case the Bank both concealed and misrepresented the information it had touching Schardt's speculation and interest in a gambling concern. And the Courts hold that evidence of stock gambling, such as the Bank had in this case, rendered the employe wholly unworthy of trust, and *demanded his immediate dismissal.*

In contrast with the action of the Bank in not reporting the

[1] Stipulation, q. 4, Trans., p. 106.
[2] Cashier's bond, Trans., p. 7.

speculation to the Company, and in representing that nothing unfavorable, past or present, was known, is the action of the Company when it did receive notice of speculation, and the action of the Bank when the bond was canceled by the Company. Immediately upon learning that the employe had been speculating, the Company canceled the bond.[1] So soon as the Company did this, and notified the Bank why it did so, the Bank caused an examination of the books and accounts to be made.[2] The examination was scarcely begun when the stupendous frauds appearing on the books were discovered, and the wisdom of the rule of law announced by the Courts verified. The examination began with a trial balance from the individual ledger compared with the general ledger.

No explanation has been offered to justify or excuse the breach of the condition in the teller's bond, or the misrepresentation of the Bank in procuring the cashier's bond.

No recovery can be had under either bond.

IV.

MISREPRESENTATION OF CONDITION OF BANK BOOKS.

Each bond was procured by representing to the Company that the books and accounts of the employe had been examined and found correct to January, 1892, when the teller's bond was renewed, and to January, 1893, when the cashier's bond was issued. These representations were material and false.

When the teller's bond expired in January, 1892, the Bank applied for a renewal for another year. The Company replied that the bond could not be renewed until the Bank stated that the books and accounts of the employe had been examined and *verified*. Thereupon the Bank, through its cashier, made the representation that this had been done by the finance committee of the Bank to December 31, 1891. The bond was then renewed.

[1] Dep. Cooley, q. 3, Trans., p. 98.
[2] Dep. McEwen, cross-q. 1, Trans., p. 35.

When application was made for the cashier's bond in January, 1893, this Bank represented to the Company that the books and accounts of the employe had been examined to December 31, 1892, and found correct. The cashier's bond was then issued.

On December 31, 1891, the *books of the bank* showed the employe was a defaulter for the sum of $23,365.44, of which amount $19,600 represented understated liabilities, and $3,765.44 abstractions from the notes in a bank having only $50,000 capital.

It must be conceded that there was no *verification.* The only member of the committee testifying, admits that *Schardt's word was accepted* for the correctness of the amount appearing upon his books to be due depositors, and *admits there was a way* to *verify* the statement.[1] And, in this case, the comparison could and should have been made. The Bank, knowing that this verification *could* have been made, and that it was not made, *knew* that its statement to the Company that the books and accounts had been examined and *verified,* was false.

The statement was also false because there was no *examination.* The *assets* were no doubt examined, but the *books* were not. The assets were examined with a view to the *solvency* of the notes and collaterals, but the *amount* of the assets and the *amount* of liabilities *could not* have been examined.

It no doubt will be conceded that to open each book, glance at a page on each, and close them up, would not be an examination of such books; and scarcely more than this was done, because there was no comparison of ledger balances, and no correct footing of the notes in the Bank.

The representation was that the books and accounts *had been examined and verified, not* that the employe was supposed to be honest and correct in his accounts; *not* that the Bank believed that an examination would disclose no shortage; *not* that the Bank had sufficient confidence in the integrity of Schardt to suppose an examination unnecessary. Whatever idea may have been entertained by the Bank with respect to the correctness of its own affairs, it is nevertheless true that the Bank, without qualification,

[1] Dep. Eatherly, cross-qq. 60, 61, and 67, Trans., pp. 57, 58.

represented that it had done a particular thing when it had not done so.

The first thing that would suggest itself to an examining committee would be to compare ledger balances, especially as this was the only means of ascertaining even approximately, whether the books were correct; and it is equally plain that a correct comparison should be made between the aggregate amount of notes in the Bank and the amount called for by the books of the employe intrusted with the collection of the notes. It can not be that a bank committee supposed that an examination of the books of the Bank consisted in asking the employe how much assets he should have, and then counting the assets to see that they agreed with the amount the employe said he should have; and yet it appears that this Bank scarcely did this, because the notes of the Bank were less than the amount the books of Schardt called for. No doubt some of the finance committee did have meetings as represented. No doubt they examined the notes, stocks, bonds, etc., held by the Bank, but this was done with a view of determining the solvency and value of the securities. The committee, supposing Schardt to be honest, did not deem an examination of his books necessary. The Bank *may* have supposed the representation that the books had been examined and verified a mere form; but it was not a form; it was a question of fact, and was false.

One of the committee says they looked to the cashier, who was an expert bookkeeper, to see that the books of the Bank were kept correctly.[1] The cashier, Sykes, says he never had anything to do with the examination of the books.[2] No member of the committee has testified that he did not know how such examinations could have been made, and no one of them had the courage to say he was ignorant of what should have been done. The only one who does testify concerning what was done says they had Schardt's word for the correctness of the false account.[3]

On December 31, 1892, the *books of the bank* showed the employe was a defaulter for the sum of $73,715.44, of which amount

[1] Dep. Jno. A. McEwen, qq. 4 and 10, Trans., pp. 90, 91.
[2] Dep. Sykes, cross-qq. 5 and 7, Trans., p. 79.
[3] Dep. Ratherly, cross-q. 61, p. 57.

$69,700 represented understated liabilities, and $4,015.44 abstractions from the notes in a bank having a capital of only $50,000.

When this purported examination was made in December, 1892, the Bank knew the employe had been speculating "to some extent" and had been part owner of a "bucket shop." Whatever may be said of the former examinations, this knowledge made a careful examination imperative.

When the teller's bond was renewed in January, 1892, the situation of the parties was this: The employe upon whom the bond was desired had occupied the position of teller in the Bank since 1888. The only means of knowing the fidelity with which he had handled the funds of the Bank was to make inquiry of the Bank. The officers and directors were assumed to be reasonably prudent men. If a reasonably prudent examination failed to disclose any default, the Company could afford to renew the bond. The inquiry was made, and answered by the Bank, and the bond renewed. Upon the other hand, the books of the Bank were out of balance $19,600. The notes in the Bank were less by $3,765.44 than called for by the books kept by the employe, who was also the custodian of the notes. The universal, and indeed the *only* way to examine the books of the Bank was to compare the balance on the books kept by Schardt with the balance on the books kept by the individual bookkeeper. This comparison would have disclosed the shortage. The correct footing of the notes in the Bank compared with the amount called for on the books kept by the bonded employe would have disclosed the shortage. It is customary in all banks to compare trial balances every thirty days. It was customary to do this in this Bank until 1890, but after that it was never done. At any time within three years prior to the failure of this Bank, a comparison of trial balances would have detected this shortage of the bonded employe. The cashier of the Bank during all this time was an expert accountant and a member of the finance committee making the examinations.[1]

When the cashier's bond was issued in January, 1893, the situation of the contracting parties was this: Schardt had been in the Bank from 1887 to January, 1893. The only information obtain-

[1] Dep. McEwen, qq. 6 and 10, Trans., pp. 90 and 91.

able with respect to his business habits and integrity was through the Bank. He had just been elected cashier, and the Bank desired a bond in the sum of $20,000. The Company desired certain information before assuming the risk. It applied to the Bank. Within the keeping of the Bank was his business career of the six preceding years. The official report showed the Bank to have been well managed, so well, in fact, that its accumulated surplus exceeded the half of its entire capital. It was, therefore, not negligent for the Company to assume that its officers were reasonably skillful bank officials. If Schardt had properly and honestly handled the funds of the Bank for more than five years, the presumption would be that he was an honest employe and worthy of the risk to be assumed by the Company. If irregularities in his accounts had existed to any appreciable extent, the Bank would have detected it, assuming the books and accounts had been examined. If he had been guilty of default or misconduct, the Bank would have observed it in the course of so long a period.

The Company was unwilling to issue this bond without making such inquiry. Therefore, knowing that such information could only be obtained from the Bank, it made the inquiry as to whether the books and accounts had been examined, and, if so, whether they were found correct. This statement of the Bank in reply to the inquiry was expressly made a part of the contract.

No explanation has been offered by the Bank to explain why these examinations were not prudently made. The record does not present any fact or circumstance to show good faith or prudent conduct upon the part of the Bank officials.

It is quite true that several months were consumed by the expert accountants in ascertaining the *exact amount* of the shortage, but only a *few hours'* examination of the *bank books* were necessary to discover that there was a *very large default*[1]

It is also true that there were certain *items* of the default which required the calling in of all pass books and a very searching investigation to ascertain the *exact* amount of the Bank's loss. But all these items may be eliminated in the discussion of this case, since they nearly all occurred after January 1, 1893. Complaint

[1] Dep. McEwen, cross-q. 5, p. 36.

is directed to the failure of the Bank officers in detecting the enormous losses *apparent upon the books of the Bank;* and the failure to discover *some part* of the many errors in the Bank *books,* which could have been discovered with the *slightest* examination. Whatever was shown upon the face of the Bank books, revealing the shortage, should have been known, and why it was not known has received no satisfactory answer, either in the record or in the argument of counsel. And this failure becomes the more startling when the depositions of the Bank officers are considered.

Eatherly seems to have been the head and front of all examining committees of the Bank. He undertakes to show how very careful and scrutinizing he was at all times in making examinations. He would have the Court understand that he was careful and even exacting, and he is convincing in his efforts to show that he not only knew just *what* should be done, but just *how* to do it. And yet the astonishing fact remains that the shortage was *not* discovered, *although* the *simplest* and *only possible* examination could not fail to have disclosed the loss.

These officers do not plead ignorance and good faith, but knowledge and the performance of duty. They do not ask to be excused upon a plea of failure to discover the loss because they did not know what they *should* do, and therefore did all they *knew how,* but they show that they knew all about bank examinations and insist that they did in fact make thorough investigations, and yet the failure to discover the loss remains a mystery. There is eliminated from the discussion all the errors not discoverable except by calling in pass books, failure to enter deposits upon the books, failure to enter money collected, and failure to enter notes discounted, yet after eliminating all these, there remains a shortage, December 31st, 1891, when the examination was made to procure the last renewal of the teller's bond, of $23,365.44; and on December 31st, 1892, when the examination was made upon which the cashier's bond was procured, there was a shortage of $73,715.44. *All this shortage appeared upon the books of the Bank.*

The total shortage, as finally fixed, was on January 1st, 1892, $28,167.34. Of this amount, $23,365.44 was apparent upon the

bank books, consisting of $19,600 less deposits on the books kept by Schardt than was shown on the individual ledger, and $3,765.44 less notes owned by the Bank than the amount called for on the Bank books.

In the same manner, the total shortage, as finally fixed, was on January 1st, 1893, 78,817.24. Of this amount, $73,715.44 was apparent upon the Bank books, consisting of $69,700 less deposits on the books kept by Schardt than was shown on the individual ledger, and $4,015.44 less notes owned by the Bank than the amount called for on the Bank books.[1]

Now, *after* January 1st, 1893, Schardt did embezzle the funds of the Bank in almost every imaginable way, but all this is beside the question, since the last examination, affecting the rights of the Company, was made December 31st, 1892, when the cashier's bond was procured, and on December 31st, 1891, when the last renewal of the teller's bond was procured.

The effort is made to show how very difficult it would have been to compare ledger balances, which comparison at any time in three years preceding the failure of the Bank would have disclosed the shortage. Witnesses are introduced to show what a long time it would have taken to procure a trial balance from the individual ledgers for comparison with the general ledger balance, which would have revealed the default. One witness says it would have taken twelve hours, another twenty-four to thirty-six, yet the bookkeeper who *did* take off these balances before they were discontinued in the latter part of 1890, says that he *always* did so between the close of business one day and the opening of business the next.[2]

When this teller's bond was renewed in January, 1892, it was, in legal effect, the making of a new contract of insurance.

Biddle on Insurance, Sec. 341.
May on Insurance, Sec. 70a.

The Supreme Court has thus defined the duty of bank directors:

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[1] Trans., q. 43, p. 42.
[2] Dep. Boench, q. 13, p. 76.

We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled under the law, to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision.

Briggs v. Spaulding, 141 U. S., 132.

The Supreme Court of Tennessee has thus stated their duty:

Directors, by assuming office, agree to give as much of their time and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are inattentive to these duties, if they neglect to attend meetings of the board, if they turn over the management of the business of the company to the exclusive control of other agents, thus abdicating their control, then they are guilty of gross negligence with respect to their ministerial duties; and if loss results to the corporation by breaches of trust or acts of negligence committed by those left in control, which by due care and attention on their part could have been avoided, they will be responsible to the corporation. The diligence required from them has been defined as that exercised by prudent men about their own affairs, being that degree of diligence characterized as ordinary. If a less degree of diligence is exercised, the negligence is gross, and for losses consequent he is liable.

Wallace v. Lincoln Savings Bank, 5 Pickle, 652.

The Company had the right to assume that the directors of this Bank had done what the law required of them, and that they had at least exercised ordinary diligence in the conduct of the Bank.

The duty of the paid officers of the Bank must be greater than this. And when the books of the Bank clearly show a large default, easily discoverable by the exercise of the most ordinary examination, the failure of the paid officers to discover the default is more than mere neglect. The cashier was an expert accountant.[1] The *only* way the examinations could *possibly have been made* would have shown the default.

The information sought by the Company, and the representations made by the Bank with respect to these examinations, were matters peculiarly and exclusively within the knowledge of the Bank. The Company had the right to rely upon its representa-

[1]Dep. McEwen, q. 4, Trans., p. 90.

tions, and for that reason the duty of knowing and telling the truth was imperative.

Pom. Eq. Jur., Sec. 888.
Morse on Banks, Sec. 21.
Biddle on Insurance, Sec. 462.
Cooley on Torts, Sec. 499.
Trimble v. Reid, 31 S. W. Rep., 861 (Ky.).
Franklin Bank v. Cooper, 36 Me., 179, 197.
Graves v. Lebanon National Bank, 10 Bush., 23.

The last case cited is somewhat similar to the one at bar, except that the surety in that case was an individual; but the law of the case must be the same, whether the surety be an individual or an insurance company. Whatever differences there may be between these two classes of sureties, it is not with respect to the principle laid down in that case. There may be a difference with respect to the duties and obligations imposed by the terms of the contract where the sureties are individuals, which may be governed by somewhat different principles from cases in which an insurance company is the surety. In the latter class of cases the courts may presume that all the conditions and duties to be performed by the beneficiary are embraced in the contract, while in the former cases the courts may be more liberal with respect to matters which release the sureties from their obligation. And in another respect, with individual sureties, the obligation may be more strictly construed that in cases where insurance companies become sureties, but *no* case can be found in which the rights of the sureties are in any respect different, whether they be individuals or insurance companies, with respect to the release of the sureties because of material misrepresentations. In the last case cited, the Court says:

A fraud may be perpetrated as well by the assertion of facts that do not exist, ignorantly made by one whom the person acting upon the assertion has the right to suppose has used reasonable diligence to inform himself, as by concealing facts known to exist, which, in equity and good conscience, ought to be made known.

We have, therefore, a case in which the directory of the bank held out to others as a trustworthy officer, a man who had been guilty of repeated embezzlements and frauds, all of which might have been discovered by the exercise of slight diligence.

This case was affirmed in *Deposit Bank* v. *Hearne*, 48 S. W. Rep. 160. (Ky., 1898.)

In the case at bar, the officers not only had in their employ an employe who has been guilty of repeated embezzlements, all of which might have been discovered by the exercise of slight diligence, but facts touching his conduct which imperatively required his immediate dismissal, and a most careful examination of his accounts. Yet no careful examination was made, but the statement to the proposed surety *was* made that the books and accounts *had* been examined and *had been found correct.* The slightest examination would have shown the default. Not one page of the books was correct, and the incorrectness was apparent upon each page. Neglect, in such case, is followed by all the consequences of bad faith. "If," in the language of *Knapp* v. *Bailey*, 79 Me. 195, "a party has knowledge of such facts as would lead a fair and prudent man, using ordinary caution, to make further inquiry, and he avoids the inquiry, he is chargeable with notice of the facts which, by ordinary diligence, he would have ascertained. He has no right to shut his eyes against the light before him. He does a wrong in failing to heed the signs and signals seen by him. It may be well concluded that he is avoiding notice of that which he, in reality, believes or knows."

A statement recklessly made, without knowledge of its truth, is a false statement, knowingly made.

Cooper v. Schlisinger, 111 U. S., 148.
Nevada Bank v. Portland Bank, 59 Fed. Rep., 338.

In *Mouler* v. *Ins. Co.*, 111 U. S., 335, it is said:

> Looking into the application upon the faith of which the policy was issued and accepted, we find much justifying the conclusion that the company did not require the insured to do more, when applying for insurance, than observe the utmost good faith, and deal fairly and honestly with it in respect of all material facts about which inquiry is made, and as to which he has, or should be presumed to have, knowledge or information.

In the case at bar the Bank held out as trustworthy an employe who had been guilty of repeated embezzlement, all shown upon his books. The Bank represented that these books had been ex-

amined and found correct. The facts were exclusively within the keeping of the Bank, and its representation could not be verified elsewhere. This information was sought for the purpose of deciding upon the issuance of the bond, and the Bank was informed of this purpose.

These material misrepresentations prevent a recovery under either bond.

V.

SUPERVISION OF EMPLOYE AND INSPECTION OF BANK BOOKS.

The Bank failed to observe the conditions of the teller's bond requiring an annual inspection or audit of the books and accounts; and to observe all due and customary supervision over the employe for the prevention of default.

These defenses apply alone to the teller's bond. The bond states:

> "The following provisions are also to be observed and binding as a part of this bond:
>
> "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default.
>
> "That there shall be an inspection or audit of the accounts and books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

The condition with respect to supervision for the prevention of default is not thought by counsel for the Bank to refer to the books and accounts of the employe, but "supervision personally of the employe."

If the condition of the bond refers personally to the employe, then there was a clear failure of the Bank to examine into the conduct of the employe when he admitted having speculated, and having been part owner in a "bucket shop," and also when additional

information was received by anonymous letters that he was still speculating. If an examination had been made at this time, the statement of the employe that he had sold out and quit speculating would have been shown to be false, because he was, during all this time, speculating and embezzling the funds of the Bank.

The contention of the Company is that the language used in the bond is unambiguous, and means just what it says; that is, all due and customary supervision, and the purpose of the condition is expressed in the words "for the prevention of default." In other words, the Company agreed to reimburse the Bank any loss resulting from the default of the employe, upon the condition that the Bank would exercise all due and customary supervision over the employe *for the prevention of default.* The condition is analogous to the language of fire insurance contracts prohibiting the storage of combustibles, requiring precautions against fire, and requirements looking to the protection of the property against fire. It is analogous to conditions in life policies looking to the preservation of good health.

What interest could the Company have in requiring examinations other than to prevent a default? And hasn't the Company the right to require supervision to prevent the default, if there be one, becoming larger by continued neglect, and thus by failing to detect the dishonest employe, enable him to continue his dishonest acts?

The condition was neither harsh nor hostile to the interests of the Bank. The temptation and opportunities were sought to be limited by requiring all due and customary supervision, so that the risk assumed by the Company would not be so great; and did not contemplate the cessation of the duty imposed by law upon the Bank to use all due and customary supervision over the employe to prevent losses by the stockholders and creditors of the Bank. Upon the contrary, the condition of the bond made it clear that the Company intended the Bank to fully understand that if all due and customary supervision for the prevention of default was not exercised, it would not be responsible to the Bank.

The Company did not undertake the unnecessary and uncalled for risk of protection to the Bank against losses occurring because

of the lack of due and customary supervision by the officers of the Bank, but only the losses that might result *after* the exercise of this supervision. The indemnity was to protect the Bank against loss that could not be prevented where the legal duty of the Bank officials was exercised. The Bank officers could not abandon their duty to exercise all due and customary supervision over the employe for the prevention of default, and the Company did not contract to assume such a risk. The contract was mutual, the Bank was to exercise due and customary supervision for the prevention of default, and the Company was to be responsible for any loss resulting *after* this supervision was exercised. If the condition of the bond does not mean this, it does not mean anything at all, and is mere surplusage. This construction is reasonable, and is clearly the intention of the contracting parties. If the Bank was bound under this condition of the bond to exercise all due and customary supervision over the employe for the prevention of default, the question of what is due and customary supervision only remains to be determined. The law has already determined what this is. Ordinary care and attention is the test even for directors, and much greater care and attention from the paid officers of the Bank. Citation of authorities is unnecessary for this proposition.

If, however, the condition of the bond does not refer to such supervision as the law requires, but refers to the supervision exercised in this Bank when the bond was obtained, or the supervision exercised by other banks generally, the result is the same. The facts show that neither the supervision exercised in this Bank when the bond was procured, nor the supervision exercised generally by other banks, nor the supervision required by law to be exercised, was, in fact, exercised by this Bank and no ingenuity can suggest any plausible theory of what supervision was contracted for, which will show a compliance with this condition upon the part of the Bank. And an examination of the facts in the record will verify the statement that due and customary supervision, in whatever sense the words could have been used, was not, in fact, exercised by the Bank over the bonded employe.

The facts in the record show that up to 1890 it was customary in this Bank to compare ledger balances as often as every thirty

days, but that thereafter no comparisons were ever made;[1] and that the employe commenced to abstract the funds of the Bank as soon as this supervision ceased.[2] When this bond was originally procured this supervision prevailed in the Bank. It then and now universally prevails in all other banks, and is the only possible way banks have of knowing anything about their condition, and in no other way can the books of the bank be kept in balance, or their condition be known.[3]

The first act of supervision would be to see that the books in the Bank were kept in balance. This was not done during the entire year. At the beginning of the year they were out of balance $19,600; at the end of the year, $69,700 — nearly twice the capital of the Bank, and nearly one-half the total deposits.[4]

The next act of due supervision would be to see that the assets called for by the Bank's books were in the Bank. At the beginning of the year the notes in the Bank were $3,765.44 less than the books called for; at the end of the year they were $4,015.44 less.[5] The total amount of the notes in the Bank were less than $200,000.

The by-laws of the Bank required the cashier to see that all the accounts and books of the Bank were properly kept.[6] The cashier, during the whole of 1892, was an expert bookkeeper.[7] He states that he was never present at any examination, and merely copied the statement of assets and liabilities from the daily balance book as his report to the directors.[8] Although an expert bookkeeper, he did not exercise sufficient supervision over the books of the Bank to see that they were in balance. Starting at the beginning of the year out of balance $19,600, they ran up to $69,700 at the end of the year, yet the expert bookkeeper, charged by the rules of the Bank with this duty, failed to supervise them sufficiently to discover that they were out of balance at all.

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[1] Dep. Boench, q. 6, p. 75.
[2] Trans., p. 15.
[3] Dep. Harris, p. 74; Dep. McLaughlin, p. 80; Dep. Duncan, pp. 84–86; Dep. Fischer, p. 89.
[4] Dep. McEwen, cross-q. 43, Trans., p. 42.
[5] Dep. McEwen, cross-q. 43, Trans., p. 42.
[6] Dep. Pryor, q. 11, Trans., p. 70.
[7] Dep. McEwen, q. 4, Trans., p. 90.
[8] Q. 7, Trans., p. 79.

It is certain that "due and customary supervision *to prevent a default*" was not exercised by the Bank.

This record affords a very striking illustration of the necessity of due supervision of employes to prevent a default. This employe was honest and faithful *until* the Bank *ceased* to exercise due supervision. The books were kept in balance until just before the defalcation commenced. The ledger balances were compared each thirty days, and made to agree. So soon as this act of supervision *ceased,* the defalcation *commenced.*

With respect to the other condition of the bond requiring an inspection and audit of the books and accounts at least once a year on behalf of the employer, it is not contended that the finance committee did not *partially* examine the *assets* of the Bank, no doubt with a view of declaring dividends, but there was no "inspection or audit of the *books and accounts of the employe*" during the year 1892. This language clearly contemplates a reasonable, careful, and prudent examination of the books and accounts of the employe in order to ascertain their condition. There is not a page of the books kept by the employe during the year 1892 that is correct, and that could not have been found to be false if examined.

The words "inspection or audit" have a meaning well understood. They have no reference to the financial condition of the Bank. They refer to the particular books and accounts kept by this employe, and *these* books and accounts were required to be examined. There is no pretense that this was done, and hence this condition of the bond was breached.

VI.

ERROR IN AMOUNT OF DEFAULT.

If the Court should be of opinion that there should be a recovery under the cashier's bond, it is important to call attention to an error in the amount of the default claimed to have occurred during the life of this bond.

This bond only undertakes to indemnify the Bank against the default of the employe "constituting embezzlement or larceny."

The only evidence of the default is the report and depositions of the expert accountants who examined the affairs of the Bank, and in their report is included $5,992.35 "of overdrafts allowed and not authorized.[1]

This may have constituted a fraudulent act by the employe, but it certainly can not be either embezzlement or larceny. Under no construction of the terms of the bond can this amount be deemed a part of the loss sustained by the Bank for which it can make claim against the Company.

The Court of Appeals, in its opinion, says:

> Objection is made to an item included in the report of the expert bank examiners, on which the decree was rendered, of $5,992.35 of "overdrafts allowed and not authorized." It is insisted that this was not embezzlement or larceny. *We do not know whether it was or not.* It *might* be, because embezzlement or larceny may be committed through the process of overdrafts. This question was not made by exceptions or passed on in the Circuit Court, and was, it is said by counsel, only brought to attention there at the time the decree was entered. It is evidently an afterthought, and there being *no proof showing the facts in relation to the overdrafts,* nor why they were by the examiners included, neither the trial Court nor this Court can say they were *not embezzlements* or larcenies. There is no proof to sustain this objection, which comes too late.

If the Court refers to the statement of the experts in speaking of a failure of plaintiff in error to except to their report, it is respectfully submitted that the Court is mistaken in assuming that this report of experts was made under the direction or decrees of the Court. They were merely accountants employed by the Bank officials to examine the affairs of the Bank for their own use, and they were introduced as witnesses to testify to the result of their examination.

It is respectfully submitted that it is incumbent upon the Bank to show a loss within the plain and unambiguous language of the contract. The experts could have no competent knowledge of the matter except the books of the Bank. They report overdrafts *allowed, and not authorized.* Since the Court is unable to say that this is "embezzlement or larceny," is it not failure on the part of the claimant to make out a case? If the Court can look to the

[1] Trans., p. 47.

statement of counsel, which is outside the record, still there was no exception to make by plaintiff in error. All that it could do was to insist that the item should not be allowed. There was no report to file exceptions to, and the statement of counsel that the attention of the trial judge was directed to the point before final decree, is sufficient evidence that the question was not an afterthought, raised in the Appellate Court for the first time. What else could have been done by counsel upon the hearing, except to insist that the item should not be allowed? The bond did not undertake to protect the Bank against fraud, bad judgment, and all kinds of dishonesty, but only losses sustained which constituted "embezzlement or larceny." When claim is made for a loss it should affirmatively appear that the loss comes within the character of loss contracted against, and not require the Company to show that a loss has not been sustained. The expert accountants were not supposed to know what particular defaults were contracted for, and, no doubt, were entirely ignorant of the terms of the contract.

VII.

CONCLUSION.

It is apparent from the record and the defenses urged by the Company to defeat a recovery under each bond, that each and every defense is based upon matters affecting the merits of the risk assumed. Each and every one of them relate to matters which were of the essence of the contracts. They are not technical, do not relate to matters occurring after the loss, but they concern matters which were intended to, and which would have prevented loss to the insured, if observed in any degree of prudence and care.

No greater care, and no higher degree of skill is insisted upon by the Company than such as reasonably prudent bank officers usually possess and exercise. The Company does not insist that the Bank officials should have exercised any more prudence and good faith in dealing with it than the prudence and good faith

legally and morally required of bank officials in all other dealings between them and other persons. But this much is insisted upon, and should be sustained by the Court. And the record abundantly shows that the officers of this Bank were intelligent and *knew* what their duty was, even though they did not perform it.

The loss would not have occurred if the Bank had observed *any* supervision, much less "all due and customary" supervision over its employe. The Bank would not have procured either bond, if it had reasonably examined the books and accounts of the employe, and have correctly represented the facts. The Bank would have been saved from insolvency, if it had reported the speculation and "bucket shop" dealings of the employe, as it agreed to do and had not accepted the statements of the employe without any independent investigation; and the cashier's bond would never have been obtained, if the Bank had not withheld the information it had touching the disreputable conduct and habits of its employe. The Bank obtained each bond, not through ignorance, but through neglect and bad faith, and it should not be permitted to profit by that same neglect and bad faith.

If the bad faith of the Bank is not shown in *each* of these defenses, certainly it is shown when *all* the defenses are considered together. The record discloses that the Bank did *nothing at all* to comply with its part of these contracts, and obtained them by reckless and untrue statements.

A sound public policy demands that bank officers be required to exercise good faith and reasonable prudence in the conduct of affairs intrusted to them, and it would be contrary to public policy, and greatly detrimental to the public interest, for the rule to be established that the officials of corporations can dispense with all care in overlooking employes under them if they hold a bond for a fraction of the amount which such employes may embezzle.

If the holding of the Court in this class of cases is to be that the employer, in seeking such bond, is not bound to make disclosure of such facts as may be known to him affecting the reliability of the employe sought to be bonded, even when asked in regard thereto by the bonding company, and that an answer which can by any possibility be excused as not being in bad faith, shall not

be deemed a misrepresentation avoiding the bond, and that, *after procuring such a bond,* the employer is bound to no duty and to no diligence in regard to a supervision of the employe, and all stipulations looking toward requiring the disclosure of discrediting facts known to the employer, either at the time of the issuance of the bond or becoming known to him thereafter, or stipulations regarding the supervision of the employe, are to be construed against the company with the utmost strictness and harshness, it will have the effect to increase greatly the hazard and risk of the business to the companies engaged therein, and will result in the permanent injury and loss to the public seeking such bonds, by requiring large increases in the premiums paid therefor, to cover the additional hazard and risk so incurred. It will tend to the relaxation of the duties required by law of all bank officers, and can but be detrimental to the interests of the creditors and stockholders.

The decree of the Circuit Court should be reversed with direction to dismiss the bill.

Respectfully submitted,

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1000